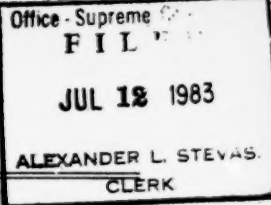


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Case No. _____



In the Supreme Court of the United States

October Term, 1982

**THE CLEVELAND ELECTRIC ILLUMINATING
COMPANY,**

Appellant,

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF OHIO

JURISDICTIONAL STATEMENT

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QUESTION PRESENTED

May the State of Ohio, by statute, constitutionally require a public utility to invest its capital for the convenience of the public to ensure reliable service in the future and simultaneously prohibit, by statute, that utility from recovering through rates such capital when prudently invested?

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REPORTS OF OPINIONS BELOW

The decision of the Ohio Supreme Court appealed here is reported at 4 Ohio St.3d 107, 447 N.E.2d 746 (1983). The underlying *Opinion and Order* of the Public Utilities Commission of Ohio in Case No. 81-146-EL-AIR is reported at 46 PUR 4th 63 (1982).

The related decision of the Ohio Supreme Court dated July 15, 1981 in *Consumers' Counsel v. Pub. Util. Comm. (CEI)*, is reported at 67 Ohio St.2d 153, 423 N.E.2d 820 (1981).¹ These decisions, along with other related decisions, are printed in the separate Appendix.²

GROUND FOR JURISDICTION

This appeal is brought to review a decision of the Ohio Supreme Court denying Appellant's appeal and affirming an *Opinion and Order* of the Public Utilities Commission of Ohio which denied recovery of Appellant's investment in four cancelled electric generating units as an operating expense in setting Appellant's rates for electric utility service to retail customers in Ohio.

Jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1257(2) to review the final judgment rendered on April 13, 1983 by the Ohio Supreme Court, the highest court of the State of Ohio. Appellant filed its Notice of Appeal with the Ohio Supreme Court on July 7, 1983.

The validity of Ohio Revised Code Sections 4905.22 and 4909.15(A)(4) was drawn into question before the Ohio Supreme Court on the grounds that, as construed and applied, they are repugnant to the Fifth and Fourteenth Amendments of the Constitution of the United States, and the decision of the Ohio Supreme Court was in favor of the validity of those statutes.

¹Hereinafter cited as *Consumers' Counsel*. Other decisions with the same title will be cited in full.

²Hereinafter cited as CEI Appx.

In the event that an appeal is not considered the proper mode of review, Appellant requests that the papers upon which this appeal is taken be regarded and acted upon as a petition for writ of certiorari pursuant to 28 U.S.C. §2103.

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

1. The Fifth Amendment to the Constitution states, in pertinent part, as follows:

“No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.”

2. The Fourteenth Amendment to the Constitution states, in pertinent part, as follows:

“No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law. . . .”

3. Ohio Revised Code §4905.22, states, in pertinent part, as follows:

“Every public utility shall furnish necessary and adequate service and facilities, and every public utility shall furnish and provide with respect to its business such instrumentalities and facilities as are adequate and in all respects just and reasonable.”

4. Ohio Revised Code §4909.15, states, in pertinent part, as follows:

“(A) The public utilities commission, when fixing and determining just and reasonable rates, fares, tolls, and charges shall determine:

• • •

(4) The cost to the utility of rendering the public utility service for the test period”

5. Ohio Administrative Code §4901: 1-9-05, Uniform Classification of Accounts for Electric Utilities – FPC, 1961 states, in pertinent part:

“The system of accounts and records, identified and designated as “Uniform System of Accounts Prescribed for Public Utilities and Licenses, effective January 1, 1961,” as adopted by the Federal Power Commission, is adopted by this Commission effective as of January 1, 1961, for electric light companies operating within the state of Ohio which are subject to the jurisdiction of the Federal Power Commission. . . . Each such public utility shall carry on its books, in addition to such additional accounts as may hereafter be prescribed by this Commission, the accounts and records prescribed in said Uniform System of Accounts effective January 1, 1961, for a public utility of its class, and shall accordingly keep such accounts in accordance with the requirements, definitions and instructions contained and set forth in said uniform system of accounts. . . .”

STATEMENT OF THE CASE

A. The facts material to the question presented.

The issue on this appeal is whether the Supreme Court of Ohio correctly held that this Court, in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), deferred completely to the local legislative will and that:

“The [Federal] Constitution no longer provides any special protections for the utility investor.”³

The facts which have given rise to this extraordinary holding can be briefly summarized.

Appellant, The Cleveland Electric Illuminating Company (CEI), is an electric utility rendering service to some 700,000 customers in northeastern Ohio. Appellant is reg-

³*Dayton Power & Light Co. v. Pub. Util. Comm.*, 4 Ohio St.3d 91, at 99, 447 N.E.2d 733, CEI Appx., p. 19 (1983).

ulated under a comprehensive regulatory scheme by The Public Utilities Commission of Ohio (PUCO) in virtually all aspects of its operations, including rates, financing, accounting, and service. Appellant is also regulated by the Federal Energy Regulatory Commission (FERC, formerly the Federal Power Commission (FPC)).

In 1967, CEI embarked with four other regulated utilities⁴ on a program for the joint construction of electric generating units — both coal-fired and nuclear — some of which have been completed and are now in operation, some of which are now under construction, and some of which have been cancelled. It is the cancellation of four of those planned units, after a substantial investment had been made in them, that gives rise to the current controversy.

Any business enterprise, in order to remain viable, should plan for the future. Appellant, however, as a regulated electric utility, is required by statute⁵ to provide service when it is demanded. This means that appellant not only *should* plan for the future but is *legally obligated* to do so. Moreover, appellant is unable to withdraw from the business without the permission of the State.⁶ Thus appellant, by statute, . . . “must anticipate load growth years in advance to maintain adequate capacity to ensure reliable service . . .” and, of course, expenditures must be made in the process in order to fulfill the statutory obligation.⁷ If, as time goes on, the anticipated demand dimin-

⁴Ohio Edison Company, Toledo Edison Company, Duquesne Power & Light Company, and Pennsylvania Power Company, together with CEI serving some 2,500,000 customers in northern and central Ohio and Western Pennsylvania. The five are known as the Central Area Power Coordination Group (CAPCO).

⁵Ohio Revised Code Section 4905.22.

⁶Ohio Revised Code Section 4905.20.

⁷*Consumers' Counsel v. Pub. Util. Comm. (CEI)*, 67 Ohio St.2d 153, at 158, 423 N.E.2d 820 (1981); CEI Appx., p. 283.

ishes, plans and construction may be prudently postponed. On the other hand, if the future requirements exceed those forecasted, there is no practical and economic way to significantly speed up the process,⁸ thus increasing the risk of a shortfall in available electric energy.

Initially, based on forecasts made in late 1972, the four units here involved (known as Davis-Besse Nos. 2 and 3 and Erie Nos. 1 and 2) were intended to be placed in service in 1983. Importantly, they were intended to be replicas of a now-licensed and operating CAPCO generating unit, Davis-Besse No. 1. As time passed, it became apparent that the rate of growth in the demand for electric service was lower than anticipated, in large part because of the effects of the 1973 Arab Oil Embargo and the resultant increased sensitivity to energy conservation.⁹ This caused appellant to postpone construction of the four units, as well as others. In addition, the Three Mile Island incident in early 1979 gave rise to a variety of substantial changes in construction requirements imposed by the Nuclear Energy Regulatory Commission and it became apparent that the original concept of duplicating Davis-Besse No. 1 would not work.¹⁰ Those regulatory changes, still not today totally ascertainable, would have added significantly to the costs of the proposed units, as they have to many others throughout the country.

⁸Certain types of generating capacity require much less time to construct, but they are usually oil-fired units which are extremely expensive to operate and which, because of international implications, have been discouraged by the Federal government.

⁹It should be emphasized, because it is frequently overlooked, that there continues to be *growth*. It is the *growth rate* that has decreased.

¹⁰The four units involved were intended to be a Babcock & Wilcox design. TMI and Davis-Besse Unit No. 1 are also Babcock & Wilcox plants.

Given these and other factors, the constructing companies (including CEI) decided in January 1980 to cancel these four units.¹¹ At that time the five participating companies had already expended approximately \$250,000,000 on them, of which some \$56,000,000 had been spent by CEI. The issue on this appeal arises from the denial of the recovery through rates as an expense of that portion of CEI's investment attributable to Ohio jurisdictional electric service.¹²

In the original proceeding before the PUCO, Case No. 79-537-EL-AIR, the Commission expressly held that (1) the initial decision to embark on the construction of these units was prudent, (2) all expenditures made had been prudent, and (3) the decision to cancel was prudent.¹³ The Commission also concluded that, in view of all the available case law — uniformly authorizing recovery of such investments in similar circumstances — the investing public had not taken into account the risk of total non-recovery and hence the utility had not been compensated for such a risk through the return allowed in previous rate cases.¹⁴ In holding that these costs could not be recovered through rates as an expense, the Supreme Court of Ohio did not disturb these findings of prudence at every step of

¹¹While not directly relevant, it is worthwhile to note that construction proceeded on several others, including three additional nuclear units.

¹²FERC has provided for recovery from CEI's interstate customers. CEI Appx., pp. 400-418. Pennsylvania has provided for recovery by the Pennsylvania members of CAPCO from Pennsylvania customers.

¹³*The Cleveland Electric Illuminating Company*, PUCO Case No. 79-537-EL-AIR, Opinion and Order, at pp. 28-29 (July 10, 1980); CEI Appx., pp. 360-362.

¹⁴This was amply confirmed by the evidence, discussed *infra*, in the later CEI rate case which is the subject of this appeal.

the process.¹⁵ This appeal, therefore, presents a straightforward legal issue.

The issue is the result of the interplay of the relevant Ohio statutes which, as now construed by the Supreme Court of Ohio, both impose upon appellant a mandatory duty not only to render utility service, but also to make investments to ensure reliable service in the future, and then deprive it of any opportunity to recover the investment made in fulfilling the latter obligation. This situation is brought about to large degree by the Uniform System of Accounts imposed upon appellant, and all other electric utilities, by FERC and, in this case, by the PUCO.¹⁶ Appellant was required by Ohio law to capitalize these expenditures and was barred from their current recovery, with the expectation of future recovery,¹⁷ whether or not the investment produced a commercial product, in this case operating electric plants. Appellant was then denied *any* recovery by the Ohio Supreme Court's announcement of "new" Ohio law.¹⁸

¹⁵*Consumers' Counsel*, *supra*, at 163, CEI Appx., p. 289.

¹⁶See 18 C.F.R. 101 (1937); Ohio Revised Code §4905.13; Ohio Administrative Code §4901:1-9-05; CEI Appx., pp. 422-430.

¹⁷There are, of course, variations in state regulatory treatment. In some jurisdictions, including Ohio, it is possible for the utility to earn a return on such investments, as Construction Work In Progress, before the plant goes into commercial service. This was not the case here, because of constraints in Ohio law not relevant to this discussion.

¹⁸The word "new" is not appellant's. The Ohio Supreme Court has expressly characterized its ruling in *Consumers' Counsel*, *supra*, as "new law": "That statute may be used to investigate the reasonableness of rate schedules in the light of new law, such as our decision in *Consumers' Counsel*, *supra*." *Consumers' Counsel v. Pub. Util. Comm. (Toledo Edison)*, 1 Ohio St.3d 22, at 24, 437 N.E.2d 586, at 588 (1982).

B. The stage at which the question sought to be reviewed was raised below.

The affected utilities cancelled the four plants in January, 1980. CEI then had pending before the PUCO an application for general rate relief, PUCO Case No. 79-537-EL-AIR on the docket of the Commission. CEI asked the Ohio Commission to permit it to amortize its investment in the four cancelled plants over a ten year period and to include the annual amortization amount in allowable expenses for ratemaking purposes. The Commission unanimously agreed.¹⁹ On appeals to the Ohio Supreme Court by three intervening parties, the Court reversed, holding that such recovery is not permitted under Ohio law. *Consumers' Counsel, supra*. As intervening appellee,²⁰ appellant suggested in its first brief to the Ohio Court that even the recovery allowed by the PUCO raised constitutional issues, with the plain implication that no recovery at all obviously would raise even more serious problems. The Ohio Supreme Court did not address the

¹⁹CEI Appx., pp. 360-362. Note that this had the effect of providing for the return of the invested capital over a ten-year span. This, of course, is not the same as a full return of that capital (because of the delayed recovery) and no provision was sought, or made, for any earnings on the investment. Such additional recovery has been permitted in a number of jurisdictions and it has been suggested that it is constitutionally required. *Virginia Electric & Power Co.*, 29 PUR 4th 65, at 96 (1979).

²⁰Under Ohio Practice, on an appeal from the PUCO to the Ohio Supreme Court (which appeal is as of right) against the interests of the affected utility, the utility is *not* a party as of right; the PUCO is the statutory appellee. While intervention is normally allowed the utility, as it was in these cases, that does not automatically entitle the utility to participate in the argument, which is permitted only if the court consents and the Commission leaves time available.

constitutional question in *Consumers' Counsel*. When the Constitutional issue was fully briefed on CEI's Application For Rehearing, the Ohio Court denied the Application without opinion. Appellant's appeal to this Court was dismissed "for want of a properly presented federal question."²¹

The remand to the PUCO raised distinct procedural problems. The rates set in PUCO Case No. 79-537-EL-AIR had already been superceded by those set in CEI's next subsequent rate case, PUCO Case No. 80-376-EL-AIR.²² In 80-376-EL-AIR, decided prior to the Ohio Supreme Court's decision, the Commission had again allowed the annual amortization of the investment in the four cancelled units as an expense. *No party had pressed an appeal from that decision.*²³ Accordingly, any adjustment of the superceded rates from the remanded case (79-537-EL-AIR) would have been meaningless,²⁴ and any adjustment in the most recent case (80-376-EL-AIR) was procedurally impossible. The Commission, therefore, instituted an investigation on its own motion, PUCO Case No. 81-1096-EL-COI, and, over appellant's objection, reduced appellant's then-current rates *pro tanto* by the amount of the amortization which had been included in the last pre-

²¹United States Supreme Court Cases A-250 (Application For Stay) and 81-1002; 71 L.Ed.2d 455 (1982).

²²See *Consumers' Counsel*, *supra*, 67 Ohio St.2d 153, at 154 n.3; CEI Appx., p. 278.

²³An appeal from PUCO Case No. 80-376-EL-AIR was prosecuted, but on completely different issues. See *Senior Citizens Coalition v. Pub. Util. Comm.*, 69 Ohio St.2d 625, 433 N.E.2d 583 (1982).

²⁴Ohio law makes no provision for refunds in such circumstances. *Keco Industries, Inc. v. The Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 254, 141 N.E.2d 465 (1957).

ceding rate case (PUCO Case No. 80-376-EL-AIR).²⁵ Appellant appealed that decision to the Ohio Supreme Court, expressly raising the Constitutional issue presented here, but the appeal was dismissed and rehearing denied, both without opinion, with the grounds for dismissal unstated and unclear.²⁶ Appellant noticed an appeal to this Court, but that appeal was dismissed "for want of a properly presented federal question."²⁷

In appellant's next Ohio jurisdictional electric rate case, No. 81-146-EL-AIR, the one here under appeal, the PUCO said that it would approve the amortization again, but denied it solely on the ground that it was bound by the decision²⁸ of the Ohio Supreme Court in *Consumers' Counsel*, *supra*:

"Applicant has requested an allowance for rate-making purposes for the amortization of the costs incurred with respect to four cancelled nuclear units. This subject was fully discussed in *Cleveland Electric Illuminating Company*, Case No. 79-537-EL-AIR, Opinion and Order, July 10, 1980, in which the Commission approved such an amortization. The Commission approved the same amortization in applicant's subsequent rate case, *Cleveland Electric Illuminating*

²⁵The Commission took no evidence and refused to consider other intervening changes in expenses, justifying its peremptory action by the imminence of appellant's next general rate case, the one here under appeal. The *Opinion and Order* of the PUCO in Case No. 81-1096-EL-COI is printed at CEI Appendix, pp. 264-271.

²⁶The Ohio Court's Journal Entries dismissing and denying rehearing are printed at CEI Appendix, pp. 258-260.

²⁷United States Supreme Court Case No. 82-704; 51 U.S.L.W. 3507 (1983).

²⁸There was no exercise of the Commission's expertise on this issue when the Commission denied recovery of this cost as an operating expense.

Company, Case No. 80-376-EL-AIR, *supra*, and approved a similar amortization in *Ohio Edison*, Case No. 80-141-EL-AIR, Opinion and Order, [February 11, 1981]. The Commission would approve the amortization again if it were not constrained by the decision of the Supreme Court of Ohio in *OCC v. Public Utilities Commission*, 67 Ohio St.2d 153 (1981). This case clearly holds that this expense is, as a matter of law in Ohio, not includable as an operating expense for ratemaking purposes. The Commission must, therefore, deny applicant's request." (Case No. 81-146-EL-AIR, Opinion and Order, at pages 27-28; CEI Appx., pp. 220-221).

On appeal, the Ohio Supreme Court affirmed, both adhering to its prior construction of Ohio law first made in *Consumers' Counsel*, *supra* and, at last, addressing the constitutional issue.²⁹ The Ohio Court held that the Ohio statutes, as construed in *Consumers' Counsel*, *supra*, do not contravene the Fifth and Fourteenth Amendments to the United States Constitution. This appeal followed.

In this case, the Ohio Commission recognized that the Ohio Court's declaration of "new law" in *Consumers' Counsel*, *supra*, had increased the perceived risk of investment in Ohio utilities, and specifically in CEI, a result anticipated by the Ohio Court in *Consumers' Counsel*, *supra*.³⁰ The Ohio Commission accordingly determined that the cost of equity capital to CEI had been increased and authorized an allowed cost of equity (and hence an allowed cost of capital) higher than it might otherwise

²⁹*Cleveland Electric Illuminating Company v. Pub. Util. Comm.*, 4 Ohio St.3d 107, 447 N.E.2d 746 (1983); CEI Appx., pp. 33-50. In deciding the constitutional issue, the Ohio court relied entirely upon its decision, on the same day, in *Dayton Power & Light Co. v. Pub. Util. Comm.*, 4 Ohio St.3d 91, 447 N.E.2d 733 (1983), CEI Appx., pp. 5-32. That case involved the disallowance of a similar, but much smaller, expense item for The Dayton Power and Light Company, another Ohio utility, relative to a cancelled coal-fired generating unit.

³⁰See 67 Ohio St.2d at 167; CEI Appx., p. 294.

have done.³¹ The Commission also authorized CEI to continue to amortize the remaining book balance of its investment for *book* purposes although *not* for *ratemaking* purposes. In a parallel appeal in this case, *Consumers' Counsel v. Pub. Util. Comm.*, 4 Ohio St.3d 111, 447 N.E.2d 749 (1983),³² the Ohio Supreme Court affirmed both these decisions.

Appellant has had a subsequent Ohio rate case, PUCO Case No. 81-1378-EL-AIR, *Opinion and Order* (January 5, 1983)³³ The Commission, again constrained by *Consumers' Counsel, supra*, declined to include the amortization of the cancelled plants as an expense. It also found it unnecessary, in the circumstances, to authorize a specific increment in rate of return to account for this item. Appellant has filed an appeal to the Ohio Supreme Court in order to preserve the record.³⁴

C. The consequences of non-recovery.

It is important to recognize the impact of non-recovery. If CEI is unable to recover its prudent investment in

³¹*Opinion and Order*, at pp. 39-40; CEI Appx., pp. 244-246. The PUCO reached the same conclusion in rate cases involving the other affected Ohio utilities. *Ohio Edison Co.*, Case No. 81-1171-EL-AIR, *Opinion and Order*, at p. 37 (November 3, 1982); and *Toledo Edison Co.*, Case No. 81-620-EL-AIR, *Opinion and Order*, at p. 27 (June 9, 1982).

³²The Opinion is printed at CEI Appx., pp. 39-50.

³³The Commission's *Opinion and Order* is printed at CEI Appx., pp. 51-159. Recovery of the cancelled plants investment is denied at CEI Appx., p. 108.

³⁴*Cleveland Electric Illuminating Company v. The Public Utilities Commission of Ohio*, Ohio Supreme Court Case No. 83-677.

the four cancelled plants through rates, it will be required to write-off that balance sheet asset in a single accounting period. In other words, *the investment will be lost forever*. The write-off will be a charge to earnings in that year and hence earnings and retained earnings will be decreased to that degree. The State of Ohio will have confiscated this investment, which the State required CEI to make, as surely as if it had ordered it paid over to the State.

The Ohio Commission, which has elsewhere recognized the severe financial impact of such a write-off,³⁵ has authorized appellant to continue to amortize the investment on its books over a period of years. The Chief Accountant of the Federal Energy Regulatory Commission, however, directed appellant to immediately write-off its entire investment, having concluded that appellant is specifically denied by law from recovery of these costs as an operating expense. FERC has been requested not to enforce the directive during this appeal.³⁶

³⁵*Toledo Edison Co.*, PUCO Case No. 81-1097-EL-COI, *Opinion and Order* (October 28, 1981), *affirmed*, *Consumers' Counsel v. Pub. Util. Comm. (Toledo Edison)*, 1 Ohio St.3d 22, N.E.2d 586 (1982). That impact will also adversely affect the consuming public, through increased future capital costs, as the Ohio Supreme Court expressly recognized and the PUCO held in the case at bar.

³⁶It might be argued that appellant has suffered no injury *until* there has been a write-off. That, however, would give rise to a loss which could not be remedied. If the write-off had occurred in 1982 (the latest calendar year for which figures are available) appellant's reported earnings per share of \$3.01 would have been reduced by \$0.51. The fact that the regulatory agency having final jurisdiction has to date been willing to preserve the *status quo* pending appeal should not be a ground for denying review.

REASONS REQUIRING PLENARY CONSIDERATION

I. OHIO REVISED CODE §4905.22 AND §4909.15, AS CONSTRUED BY THE OHIO COURT, DIRECTLY CONFLICT WITH THE PROVISIONS OF THE FIFTH AND FOURTEENTH AMENDMENTS OF THE UNITED STATES CONSTITUTION, PROHIBITING THE CONFISCATION OF PRIVATE PROPERTY WITHOUT DUE PROCESS OF LAW.

The legal issue presented can be succinctly stated. Can Ohio law constitutionally require a public utility to make an investment to ensure reliable service and, simultaneously, prohibit recovery of such investment? The answer seems self-evident; the parameters of the issue are also extremely clear.

Ohio Revised Code §4905.22, states, in pertinent part, as follows:

"Every public utility *shall furnish* necessary and *adequate* service and *facilities*, and every public utility shall furnish and provide with respect to its business such instrumentalities and facilities as are adequate and in all respects just and reasonable." (emphasis added).

There is no question that this statute requires appellant, as a public utility, to invest its capital in the present for planning and engineering for the convenience of the public to furnish adequate facilities in the future. The plain words of the statute say so, and the Ohio Court so held in *Consumers' Counsel*. The Ohio Court reiterated its stated view that "*utilities must anticipate load growth years in advance to maintain adequate capacity to ensure reliable service . . .*" (67 Ohio St.2d at 158, CEI Appx., p. 283, emphasis added). An electric utility serving 700,000 customers obviously cannot "maintain adequate capacity" without planning and engineering for the future. Large base load generating units, which have the advantage of

being energy efficient, simply cannot be built without a lead-time exceeding ten (10) years. The Commission found that the expenses at issue were proper business expenses which were prudently incurred.

Likewise, there is no question in this case that the capital invested by CEI for planning and engineering these generating units was dedicated to the convenience of the public as required by this Ohio statute. No party has ever argued otherwise. The Commission noted that "What the company seeks is the recovery of costs incurred on behalf of its rate payers to assure that adequate service could be maintained." (Quoted by the Ohio Court, 67 Ohio St.2d at 161).

Under Ohio and Federal law, such investments are not currently recoverable through rates as an operating expense. This results from the Uniform System of Accounts, prescribed by Ohio law, and there is no dispute about that fact. The accounting treatment for the capital invested in such required construction is tightly circumscribed by statute. *See* 18 C.F.R. 101 (1937); Ohio Administrative Code §4901:1-9-05.

Under the Uniform System of Accounts, planning and engineering expenditures of this kind are not shown on a utility's books as operating expenses when made, but are capitalized. CEI had no choice but to capitalize its investments in these plants from 1973 until 1980 and to postpone any recovery of or on these expenditures. Thus, the expenditures increased the eventual book cost of the property to which they relate.

If the project is completed and goes into service, the investment (including the kinds of planning and engineering expenses here under discussion) is recovered, over the property's life, through depreciation accruals, for which explicit provision is made in the Ohio statutes. Ohio Revised Code §4905.18. The investor would also have an opportunity to earn a return on this capital investment

since it would become part of the utility's rate base when completed. See Ohio Revised Code §4909.15(A)(3). See also *Bluefield Water Works v. Pub. Serv. Comm.*, 262 U.S. 679, 690 (1923), *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). Stated another way, the investor is entitled not only to get his original money back, but also to have an opportunity to earn a profit on his investment in a public utility.

Since these projects were not completed, the investment was never recognized in rate base as plant in service. No return was ever earned on the investment. Since the units were never in service, no depreciation accruals were ever recovered through rates. See *Washington Gaslight Co. v. Baker*, 188 F.2d 11 (D.C. Cir., 1950) *cert. den.*, 340 U.S. 952 (1951).

When the four planned generating units were cancelled, the invested dollars were, pursuant to the FERC Uniform System of Accounts, with the approval of FERC, transferred to Account 182 (extraordinary property loss). They were then, as the Ohio Commission initially held, to be amortized over a period of years and the annual amortization was recognized as an expense for rate making purposes as part of the "cost" of "service" under Ohio Revised Code § 4909.15(A)(4). This, the Ohio Court held in *Consumers' Counsel* was an incorrect interpretation of the statute. The Ohio Court has expressly characterized *Consumers' Counsel* as announcing "new law". It is this combination of statutory requirements and interpretations which results in the unconstitutional taking here.

Simply put, Ohio Revised Code § 4905.22 requires CEI to spend money, the Uniform System of Accounts prohibits *current* recovery of that money, and Ohio Revised Code § 4909.15(A)(4), as now applied to CEI by the Commission, prevents CEI from recovering even the return of that money, much less earning a return on that

money. That is an unconstitutional confiscation of property in violation of the Fifth and Fourteenth Amendments of the Constitution.

The precise question was confronted by the Supreme Court of Wisconsin in *Wisconsin Public Service Corporation v. Public Service Commission*, 109 Wis.2d 256, 325 N.W.2d 867 (1982). In that case, the Wisconsin Commission had held that the utility's prudent investment in a cancelled generating unit could not be recovered through rates. The Wisconsin Court reversed:

"In *West Ohio Gas Co. v. Comm'n.* (No. 1), 294 U.S. 63, 72 (1935), the United States Supreme Court stated that, "development expenses to foster normal growth are legitimate charges upon income for rate purposes as for others." In this case, there is no dispute that the precertification expenditures were prudent. Utilities have a statutory duty to engage in such expenditures. Sec. 196.03(1), Stats., states:

"Every public utility is required to furnish reasonably adequate service and facilities." *It is arbitrary and capricious to authorize a utility to expand its facilities, spend large amounts of money prudently to accomplish that goal, and then force the utility to bear the entire risk of such expenditures.*"

At the time when the Ohio Court announced its *Consumers' Counsel* decision, the question of the recovery of an investment in cancelled projects had been raised in a number of jurisdictions and it is fair to say that, in similar circumstances, recovery in some form had been uniformly permitted.³⁷ The Ohio Court recognized in *Consumers' Counsel* that "the overwhelming weight of authority from other jurisdictions supports the position of the commission [allowing amortization]." (67 Ohio St.2d at 162;

³⁷We say "in some form" because, in a number of instances, the utility in question had been authorized not only to recover its investment but also to earn a return upon it during the recovery period.

CEI Appx., pp. 287-288). Since that decision, while the vast majority of jurisdictions has authorized recovery through rates, there have been some additional cases in which recovery has been denied, sometimes on technical grounds not here relevant and, generally, without any discussion of the constitutional question.³⁸ The issue presented, therefore, potentially involves much more than an Ohio question.

In *Bluefield Water Works Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923), this Court declared the requirements of the United States Constitution regarding state regulation of utility rates:

"A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time, and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain its credit and enable it to raise the money *necessary for the proper discharge of its public duties*." (262 U.S. at 692-93, emphasis added).

³⁸The cases are too numerous to permit citation within the confines of this Statement. Recovery through rates has been authorized in some 31 jurisdictions, some of which have allowed a return on the unamortized investment. Where recovery has been denied, it is usually due to circumstances peculiar to the specific case which do not seem to raise a Constitutional issue, e.g. a failure of proof, cancellation caused by the act of a different regulatory jurisdiction, or illegality in the making of the commitment. No such questions are presented here.

This Court further stated that rates which fail to satisfy this standard

“... are confiscatory and therefore beyond legislative power. Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.” (262 U.S. at 690, emphasis added).

While this Court has not had occasion to address the constitutional implications of the cancellations of electric generating plants which have occurred in the last decade (largely because recovery of some sort was almost universally permitted until the decision of the Ohio Supreme Court), a comparable situation arose years ago because of rapid changes in the gas industry and, eventually, the conversion to natural gas and the unexpected abandonment of manufactured gas facilities. In *Pacific Gas & Electric Co. v. City and County of San Francisco*, 265 U.S. 403, 44 S. Ct. 537, 68 L. Ed. 1075 (1924), this Court held that it was error for the District Court to employ in determining the cost of service for ratemaking purposes the reduced costs of manufacturing gas made possible by new inventions but to exclude from the valuation of the rate base both 1) the proper valuation of the patented inventions and 2) “recompense for the obsolescence” of the utility property which had to be abandoned.

The importance of *Pacific Gas* is that this Court placed particular emphasis on the facts that 1) the patents which rendered the old gas plant obsolete “were of recent conception,” 2) that the utility could not have provided for the obsolescence of the old plant through depreciation charges in previous rates, and 3) that the obsolescence “could not have been long anticipated.”

The analogy is apparent. The reasons for the termination of appellant's units were of "recent conception" and "could not have been long anticipated." No one could have forecasted the reduction in the rate of growth in demand for power in the CAPCO area after the Arab Oil Embargo or the incident involving the Babcock and Wilcox unit at Three Mile Island. The planning costs were incurred prudently, and the denial of at least recovery of those costs by Ohio Revised Code §4909.15(A)(4) as construed and applied to CEI here amounts to the same kind of confiscation as was found unconstitutional in *Pacific Gas, supra*. Indeed, the Ohio Supreme Court's decision was, itself, an unanticipated event, expressly characterized by that Court as a declaration of "new law."

Justice Brandeis, dissenting in *Pacific Gas*, found only issues of fact, and not law, in the case, and proposed that justice would be better served by adopting the "prudent investment" theory of rate base:

"If a new device is adopted which involves additional investment (to buy a new plant or a patent right), the company's investment, on which the return must be paid, is increased by that amount. If the new device does not involve new investment, but the innovation involves increased current payments (like royalties for use of a process), the additional disbursement is borne by the community as an operating expense. The *cost of a scrapped plant is carried as part of the investment on which a return must be paid unless and until it has been retired*, — that is, *fully paid for*, out of the depreciation reserve. Thus, justice both to the owners of the utility and to the public is assured." (265 U.S. at 425, emphasis added).

Under his "prudent investment" theory of rate base, Justice Brandeis expressly noted that the investor is entitled to a return of his investment in utility plant, whether or not the plant is "scrapped." The classic statement of this theory appears in *Missouri ex rel. Southwestern Bell Tel. Co. v.*

Pub. Serv. Comm. 262 U.S. 276, at 292 (1923), and that statement has been cited with approval by this Court in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, at 603 (1944) and by the Ohio Supreme Court in *Ohio Utilities Co. v. Pub. Util. Comm.*, 58 Ohio St.2d 153, at 161, 389 N.E.2d 483, at 488 (1979). Recovery of its prudent investment in the four cancelled plants is all that appellant is requesting here. *Contrast NEPCO Mun. Rate Committee v. Fed. Energy Reg. Comm.*, 668 F.2d 1327 (D.C. Cir., 1981), *cert. den.*, 102 S.Ct. 2928 (1982) (FERC allowance of amortization of cancelled plants expense and denial of a return on the investment affirmed).

More recently the Court of Appeals for the District of Columbia had occasion to address a similar question. In *Washington Gas Light Co., et al. v. Baker*, 188 F.2d 11 (D.C. Cir. 1950), *cert. den.*, 304 U.S. 952 (1951), that Court affirmed the District Court's reversal of a Utilities Commission rate order which included the depreciated original cost of the utility's abandoned West Plant *in rate base* in determining the rates. By including the abandoned gas plant in rate base, the Commission in *Washington Gas Light* had awarded a return on the investment in the abandoned plant. (The propriety of the recovery of the investment in the abandoned gas plant, the issue on this appeal, was apparently not even challenged.) The Court of Appeals found that the record before the Commission was inadequate for it to determine whether the investor had already received a return for the risk of obsolescence through either 1) depreciation expense in cost of service or 2) "as a risk considered in fixing the permissible rate of return." (188 F.2d at 20). Accordingly, the decision of the Commission was vacated and remanded because it potentially had allowed the investor a return on his investment twice. The Court commented that it seemed "likely . . . in view of the prevalence in the past of the doctrine

that abandoned property would not be included in the rate base . . . that investors have been compensated for the risk of obsolescence." (188 F.2d at 20).

Here the facts are precisely the converse of those mentioned in *Washington Gas Light*. In the present situation the Ohio Court noted that "the overwhelming weight of authority from other jurisdictions supports the position of the [Ohio] commission" *allowing* recovery of such planning costs. (67 Ohio St.2d at 162). Since "the overwhelming weight of authority from other jurisdictions" allowed recovery of similar expenses, the investor had *not* anticipated the risk of exclusion from cost of service in Ohio and therefore had *not* received compensation either through rate of return or through depreciation expense for such an unforeseeable and unprecedented disallowance.

This is amply confirmed by the evidence in this case. An abrupt break in the stock prices of appellant, Toledo Edison, and Ohio Edison occurred immediately after the *Consumers' Counsel* decision on July 15, 1981. This abrupt break in stock prices was demonstrated in graphical form and admitted into evidence in the present case.³⁹ The Ohio Commission found that there was an increase in the investors' perceived risk as a result of the Ohio Court's *Consumers' Counsel* decision, announcing the "new law" that prudent expenditures in cancelled electric plants could not be recovered through rates.⁴⁰ The Ohio Court affirmed. *Consumers' Counsel v. Pub. Util. Comm. (CEI)*, 4 Ohio St.3d 111, 447 N.E.2d 749 (1983), CEI Appx. pp. 39-50. The investors' perceived risk increased, and the break in the stock prices occurred, because the market had never

³⁹These six graphs, CEI Exhibit 4A, pages 29-34, are printed following the final page of text in CEI's Appendix, filed with this Jurisdictional Statement.

⁴⁰*Opinion and Order*, at page 40; CEI Appx., pp. 244-245.

anticipated the complete confiscation of prudent expenditures on cancelled generating plants. The investors had *not* been compensated for the risk of confiscation "as a risk considered in fixing the permissible rate of return." *Washington Gas Light*, *supra*, 188 F.2d at 20. *See also*, *Missouri ex rel. Southwestern Bell Tel. Co.*, *supra*, 262 U.S. at 288-312; *Bluefield*, *supra*, 262 U.S. 692-693; *Hope*, *supra*, 320 U.S. at 603; *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 770; *Fed. Power Comm. v. Memphis Light, Gas & Water Division*, 411 U.S. 458, at 466 (1973).

The constitutional analysis presented by the Ohio Supreme Court in *Dayton Power and Light v. Pub. Util. Comm.*, *supra*, decided on the same day and relied upon in the decision here under appeal, is critically lacking. While the Ohio Court reviews a long series of decisions of this Court in the field of utility regulation, it is apparent that the discussion was taken in large part from a single law review article, Bernstein, "Utility Rate Regulation: The Little Locomotive That Couldn't," 1970 Wash. U.L.Q. 223, the thesis of which is that, in *Permian Basin Area Rate Cases*, *supra*, this Court reversed *Hope* and completely deferred to the legislative will on the question of the Constitutional rights of a regulated public utility in the ratemaking area.⁴¹ *The Ohio Court expressly adopted the proposition that:*

"The Constitution no longer provides any special protection for the utility investor."⁴²

⁴¹The author rather clearly indicates what he believes is, and apparently recommends as, the solution: "This country is accustomed to using government subsidies and even nationalization when necessary for the fulfillment of important social goals." Bernstein, "Utility Rate Regulation: The Little Locomotive That Couldn't," 1970 Wash. Univ. Law Q. 223, 264.

⁴²*Dayton Power & Light Co. v. Pub. Util. Comm.*, 4 Ohio St.3d 91, at 99, CEI Appx., p. 19.

We do not know what “*special* protection” means in this context. All that is sought by appellant here is the same kind of constitutional protection afforded anyone, whether individual or corporate, against the uncompensated expropriation of property.⁴³ It is plain that the decisions of this Court do not support the Ohio Court’s proposition. It is true that this Court held in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), that the Natural Gas Act and the Federal Constitution did not require any particular mode of rate-making. No issue is taken with that proposition here and, despite that holding as to *techniques*, it is plain that *Hope* announced – and did not abandon – *constitutional* standards.⁴⁴

The Supreme Court of Ohio drew its principal support for its sweeping proposition from this Court’s decision in *Permian Area Rate Cases*, 390 U.S. 747 (1968). In that case, this Court affirmed the then Federal Power Commission’s handling of the enormous practical problem of

⁴³*Kaiser Aetna v. United States*, 444 U.S. 164 (1979; This Court “has examined the ‘taking’ question by engaging in essentially ad hoc, factual inquiries that have identified several factors – such as the economic impact of the regulation, its *interference with reasonable investment backed expectations*, and the character of the government action – that have particular significance.” at 175, emphasis added).

⁴⁴Certainly *Hope* has been so understood. See *New England Tel. & Tel. v. State*, 95 N.H. 353, 64 A.2d 9 (1949); *Petition of New England Tel. & Tel.*, 115 Vt. 494, 66 A.2d 135 (1949); *Wisc. Commonwealth Tel. Co. v. Pub. Serv. Comm.*, 252 Wis. 481, 32 N.W.2d 247 (1948). As one commentator correctly notes, “*Hope* did not specifically end the duty to the investor, but rather redefined the standards for evaluating performance of that duty.” Liberman, “Normalized Taxes in Utility Rates: Giving Credits Where None Are Due,” 30 South Carolina Law. Rev. 703, 765 (1979).

fixing natural gas *producer* rates⁴⁵ on an area basis. That case, however, does not support the view that the United States Constitution “no longer” has any relevance in utility ratemaking or, as stated in the article followed by the Ohio Court, that there is “no longer a federal constitutional imperative”. Bernstein, *op. cit.* p. 260. On the contrary, this Court pointedly, and quite correctly, at the outset noted that:

“Producers of natural gas cannot usefully be classified as public utilities.” (390 U.S. at 756).

— an observation which would seem to make the decision, important as it may be, of limited value where, in our context, appellant is undoubtedly a public utility. More important, this Court went on to say that, even in dealing with independent producers of natural gas

“ . . . maximum rates must be calculated for a regulated class in conformity with the pertinent constitutional limitations.” (390 U.S. at 769).

This Court then examined the FPC’s actions in precisely that constitutional context.⁴⁶ In doing so, far from reversing *Hope* (as the Ohio Court has held), this Court reiterated the constitutional standards set in *Hope*. How

⁴⁵Engendered by this Court’s holding, in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), that independent *producers* of natural gas were, contrary to prior perception, “natural gas companies” within the meaning of the Natural Gas Act.

⁴⁶“Thus *Permian* specifically repeats the *Hope* requirements . . . Although the quibbling about the rate base definition may be over, the regulation of returns still entails due process considerations.” Liberman, at 766.

this can be construed by the Ohio Supreme Court⁴⁷ as an abandonment of all constitutional standards is beyond us. If the constitutional standards which have been enunciated by this Court in connection with utility ratemaking for a century or more *have* been abandoned, such a striking change in established American law should be made *here*, and not in Columbus, Ohio.

Two other points remain for discussion. The Ohio Court, in concluding that utilities *no longer* have any constitutional rights in the ratemaking process, relies, rather heavily, on the refusal of this Court to allow review in several recent cases, including this appellant's previous appeals which were dismissed "for want of a properly presented federal question." The Ohio Court's reliance on such dismissals to show that this Court has deferred *completely* to the legislative will in ratemaking matters is contrary to this Court's established practice that such dismissals are *not* resolutions of the merits underlying those appeals. R. STERN AND E. GRESSMAN, *SUPREME COURT PRACTICE*, 380-381 (5th Ed. 1978).

The other point is that, as long as rates are set in a "zone of reasonableness", there *can be* no constitutional issue. This argument, which is obviously inconsistent with the Court's statement that there is no longer any

⁴⁷Or, more correctly, by the author of the article on which the Court has based its decision. For what it is worth, the article has been cited but seldom and *never* with approval. Indeed, if anything, other commentators directly contradict it. Liberman, "Normalized Taxes in Utility Rates: Giving Credits Where None Are Due", 30 South Carolina L. Rev. 703, 763 (1979) ("there are well-established . . . constitutional duties"); Newburger, "Reforming Electric Utility Rate Regulation Reform", 28 Case Western Res. Law Rev. 556, 579 (1978).

constitutional issue in utility ratemaking, completely misses the mark. No one can quarrel with the idea that the fair rate of return, a concept established in *Bluefield* and *Hope*, is a judgmental one, nor with the proposition that, generally speaking, no constitutional issue can be distilled from a finding that the fair rate of return is 12.59% rather than 12.60%, particularly when either is supported on the record.

The question here, however, is the inclusion *vel non* of an *expense* for ratemaking purposes. It is *in* or it is *out*. Either these costs *are* recoverable or they are *not*.

This proposition must be obvious. As the Court of Appeals for the District of Columbia said in reviewing a Federal Power Commission rate order on the issue of the allocation of expenses between jurisdictions:

"Expenses (using that term in its broad sense to include not only operating expenses but depreciation and taxes) are facts. They are to be ascertained, not created, by the regulatory authorities. If properly incurred, they must be allowed as part of the composition of the rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above expenses, would be a *farce*."

Mississippi River Fuel Corp. v. Fed. Pwr. Comm., 163 F.2d 433, at 437 (1947) (emphasis added). See also *Fed. Power Comm. v. Memphis Light, Gas & Water Division*, 411 U.S. 458, at 466 (1973; "One of [the Commission's] statutory duties is to determine just and reasonable rates which will be sufficient to permit the company to recover its costs of service and a reasonable return on its investment. Cost of service is therefore a major focus of inquiry.") There is no "zone" here. If the Ohio Supreme Court decision stands, the stockholders of this utility alone

will lose \$56,000,000.⁴⁶ The “zone” has stark boundaries; in this case, given the position of the FERC accounting staff, the boundaries are all or nothing. If the utilities in this nation have no constitutional protection from such a result, *this* Court should say so. If they do have protection against uncompensated expropriation — which, under the cases decided to date, they surely have — *this* Court should make that clear by reversing the Ohio Court’s decision below.

⁴⁶The rate payer may lose a lot more, although that may not be directly relevant. The attorney who argued *Consumers’ Counsel* on behalf of the Ohio Office of Consumers’ Counsel, was quoted in the July 16, 1981 Wall Street Journal as follows:

“‘The court’s ruling probably will lead to higher utility rates eventually,’ said Gary Petroff, a senior trial attorney in Ohio’s Office of Consumer’s Counsel, the state agency that challenged the public utilities commission ruling.” (Emphasis added)

This has already happened. *Consumers’ Counsel v. Pub. Util. Comm.*, 4 Ohio St.3d 111 (1983), CEI Appx., p. 39 *et seq.*, and graphs following p. 430.

CONCLUSION

For the foregoing reasons, this Court should reverse the decisions of the Ohio Court and allow amortization of Appellant's prudent planning and engineering expenses in its cost of service.

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